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The Kaufman Report

Trade what you see, not what you think.

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Monday July 27, 2009 **Closing prices of July 24, 2009**

Markets continued their terrific performance last week as the S&P 500 rose 4.13% and the Nasdaq 100 was up 4.70%. Major indexes opened lower Friday morning but fought their way back as the day wore on, showing the buy the dips mentality may be alive and well. The Nasdaq winning streak was broken at 12, but the index still closed the day higher than where it opened.

Many technical attributes continued to improve. For example, the Nasdaq 100 has now moved above its 400-day moving average for the first time since August 2008, and it is at its highest level since 9/30/2008. The S&P 500 20-week moving average has crossed over its 40-week moving average and is above it for the first time since January 2008. The S&P 500 is at its best level since 11/5/2008. The average price per share of the S&P 1500 is at the best level since 10/6/2008. The percent of stocks in the S&P 1500 over their own 200-day moving averages is now 81.4%, the highest since 2/26/2007. Statistically three out of four stocks follow the primary trend of the market. With more than that now over the trend line which is considered to define long-term trends, bulls have plenty to crow about.

In spite these positive developments, statistics of overall demand for equities remain weak. Fortunately, supply remains even weaker with some statistics of supply hitting multi-year lows. Unless sellers become motivated pullbacks should not be too deep and the path of least resistance will be up.

We are concerned about valuation. In spite of 75% of stocks which have reported Q2 earnings coming in better than expected, aggregate earnings are still not improving. Meanwhile, P/E ratios are rising and are at the highest level seen in many months, and spreads between equity and bond yields have narrowed dramatically.

We are also concerned about sentiment. Our proprietary options indicator is showing that options buyers have become slightly bullish. This is a contrary indicator, which in June showed pessimism that accurately told us a pullback would not be too deep. It is not yet at levels we consider dangerous, but it merits watching very closely.

In the short-term stocks are still overbought so caution is advised regarding entry points. We think stocks will trade higher after a brief pullback. We also think there is the potential for a deep correction later this year. However, as we have been saying for some time, we accept the possibility that huge global government intervention along with a possibly healing economy and companies that have become very lean and mean could create a scenario where profits will start to surprise to the upside and the deteriorating earnings trend will start to change. If so, we will be more than happy to delay or even cancel our expected bearishness.

Based on the S&P 500 the short-term, intermediate-term and long-term trends are up. Traders should not hesitate to rotate out of lagging sectors and stocks and into leaders. Aggressive traders can short overbought conditions, but they may need to cover quickly since those trades are counter-trend .

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Monday July 27, 2009 **Closing prices of July 24, 2009**

The S&P 1500 (223.25) was up 0.333% Friday. Average price per share was up 0.63%. Volume was 89% of its 10-day average and 92% of its 30-day average. 64.77% of the S&P 1500 stocks were up, with up volume at 55.50% and up points at 67.20%. Up Dollars was 76.19% of total dollars, and was 50% of its 10-day moving average. Down Dollars was 138% of its 10-day moving average. For the week the index was up 4.279% on decreasing and below average weekly volume.

The S&P 1500 is up 6.67% in July, up 6.67% quarter-to-date, up 8.94% year-to-date, and down 37.36% from the peak of 356.38 on 10/11/07. Average price per share is $27.74, down 35.83% from the peak of $43.23 on 6/4/07.

Percent over 10-sma: 89.73%. 13-Week Closing Highs: 376. 13-Week Closing Lows: 6.

Put/Call Ratio: 0.928. Kaufman Options Indicator: 1.01.

P/E Ratios: 63.19 (before charges), 16.30 (continuing operations), 16.75 (analyst estimates).

P/E Yield 10-year Bond Yield Spreads: ***-57% (earnings bef. charges),*** *67% (earnings continuing ops), and 63% (projected earnings)*. Aggregate earnings before charges for the S&P 1500 peaked in August 2007 at $19.18 and are now at $3.53, a drop of 81.60%. Aggregate earnings from continuing operations peaked at $19.95 in September 2007 and are now $13.70, down 31.33%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $13.33, a drop of 39.27%.

204 of the S&P 500 have reported 2nd quarter earnings. According to Bloomberg, 75.0% had positive surprises, 8.8% were in line, and 16.2% have been negative. The year-over-year change has been -23.7% on a share-weighted basis, -12.2% market cap-weighted and -25.5% non-weighted. Ex-financial stocks these numbers are -18.0%, -8.4%, and -20.4 %, respectively.

Federal Funds futures are pricing in a probability of 79.5% that the Fed will leave rates unchanged and a probability of 20.5% of cutting rates 25 basis points to 0.00% when they meet on August 12th. They are pricing in a probability of 75.6% of no change, 19.2% of cutting 25 basis points to 0.00%, and 5.2% of raising 25 basis points to 0.50% when they meet on September 23rd.

The S&P 500 opened down on Friday but came back to make new rally intra-day and closing highs. The 20-sma has crossed back above the 50-sma.

Momentum indicators remain at high levels.

The S&P 500 bounced off its 40-week moving average to have two terrific weeks and hit the highest level since 11/5/2008. The 20-week moving average crossed above the 40-week and is above it for the first time since January 2008.

Weekly momentum indicators are not yet at overbought levels. The stochastic does have a negative divergence.

Two great weeks have propelled the Nasdaq 100 to its highest level since 9/30/08.

Weekly momentum indicators are at high levels. The weekly stochastic just had a positive crossover, although it is still in the overbought zone.

The Nasdaq 100 winning streak was broken at 12 Friday, but the index still closed higher than it opened, showing a buy the dips mentality which is still intact. The 200-sma (red) is now rising.

Last week it moved above its 400-day moving average for the first time since August 2008.

Momentum indicators remain at high levels.

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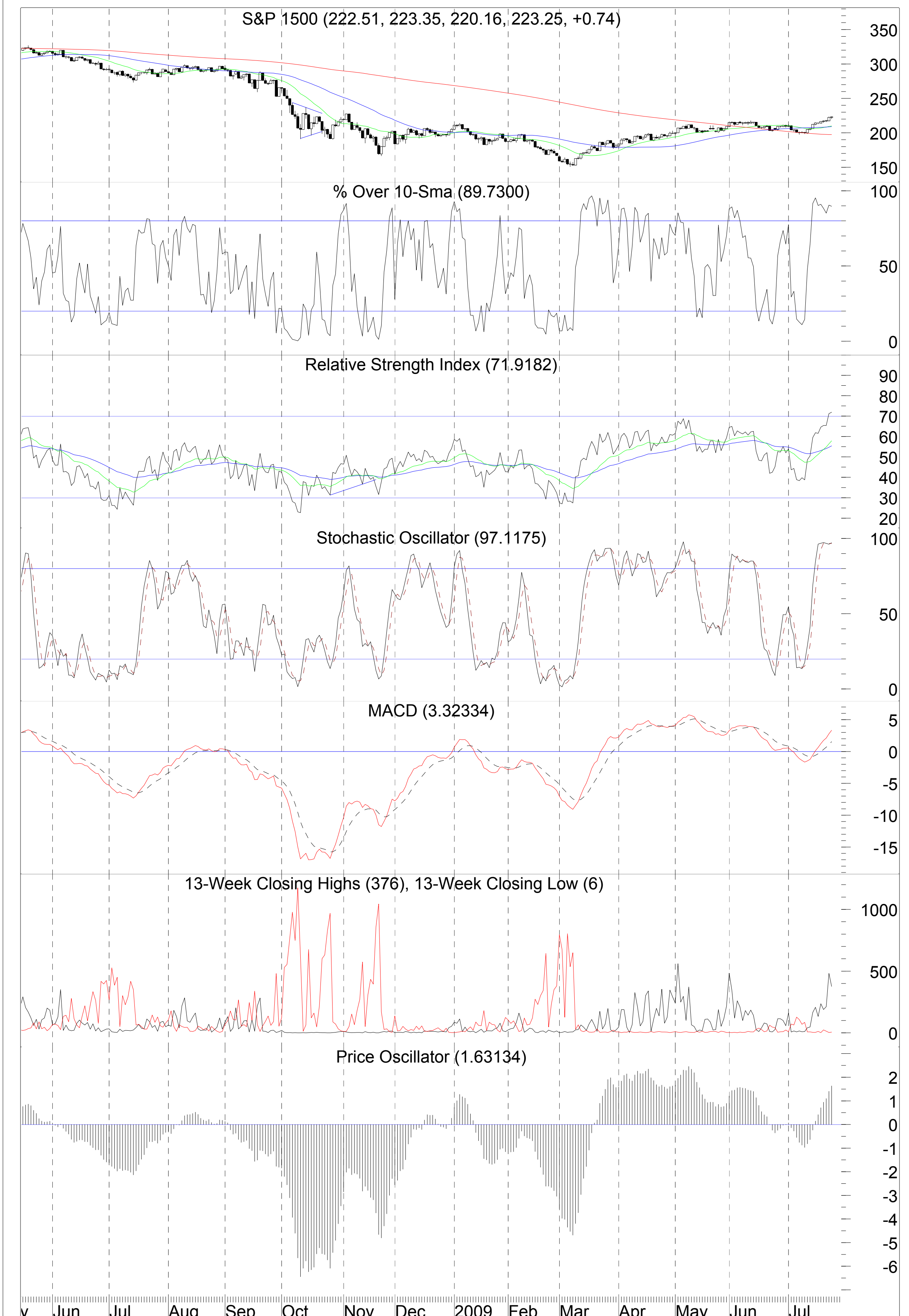
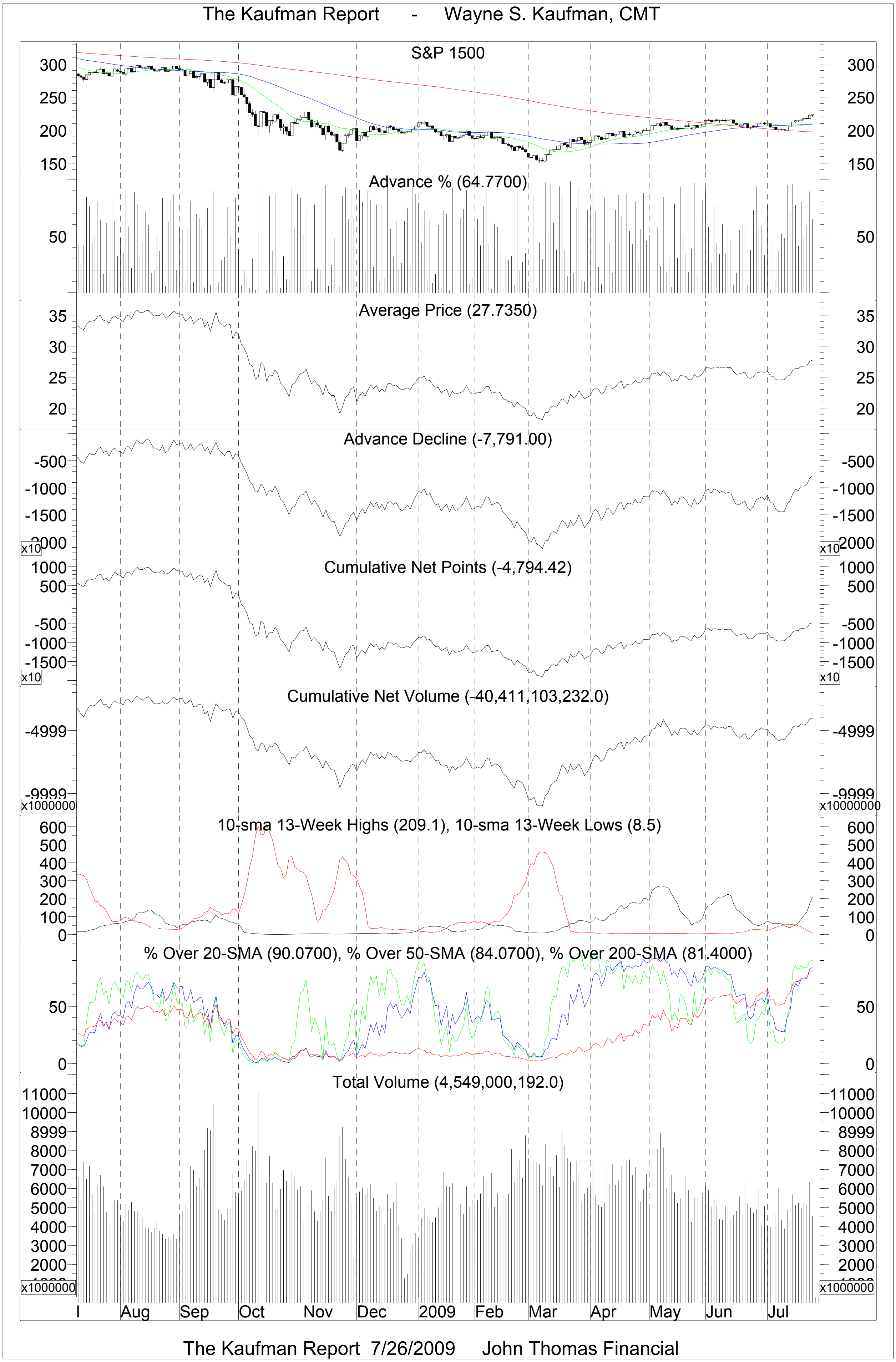


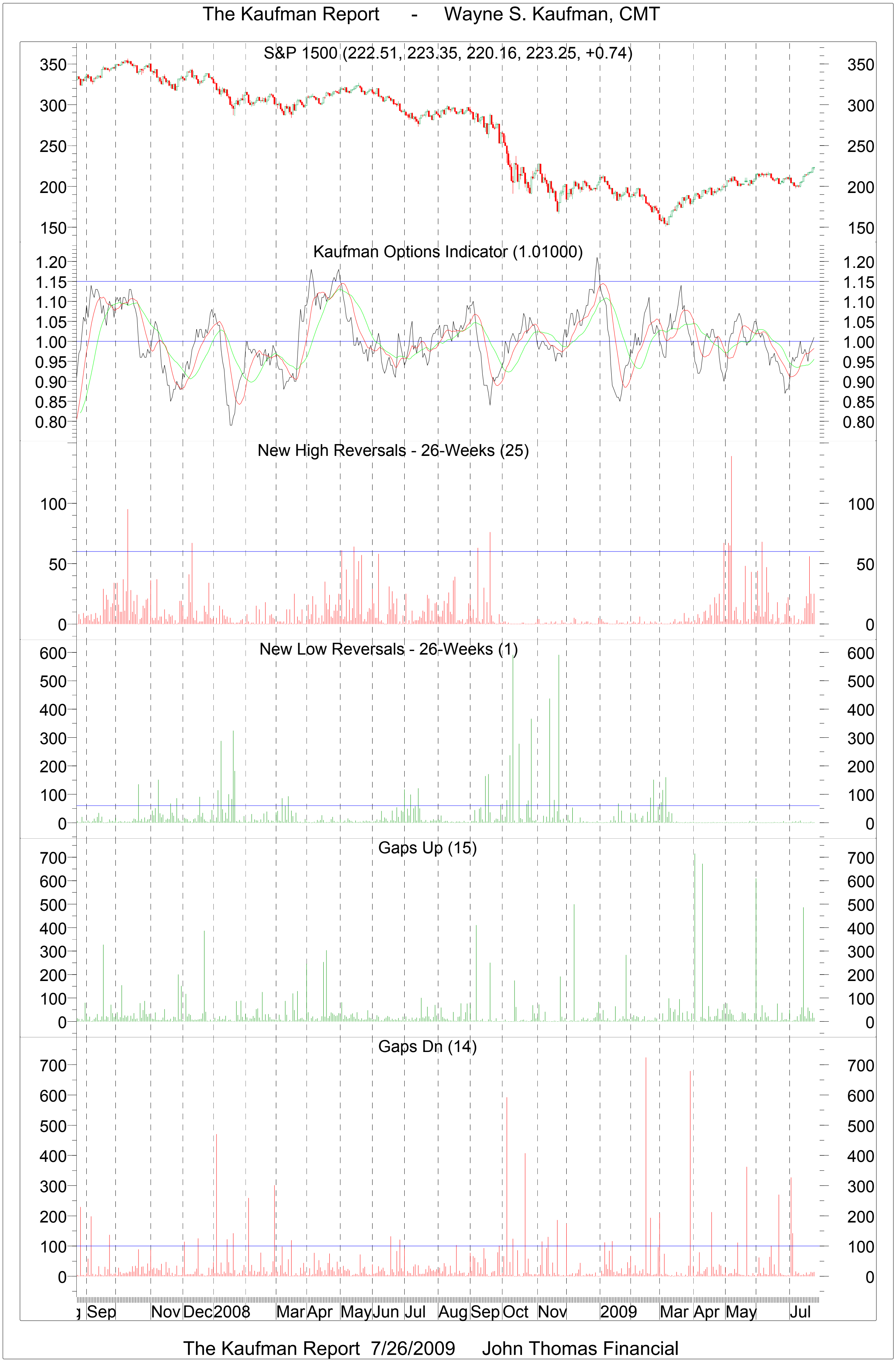
Our momentum indicators remain at high levels.

Thursday's 483 13-week closing highs was just under June 1st's 484.

Our price oscillator, a good indicator of trends, remains in positive territory after a brief stint in the negative area.

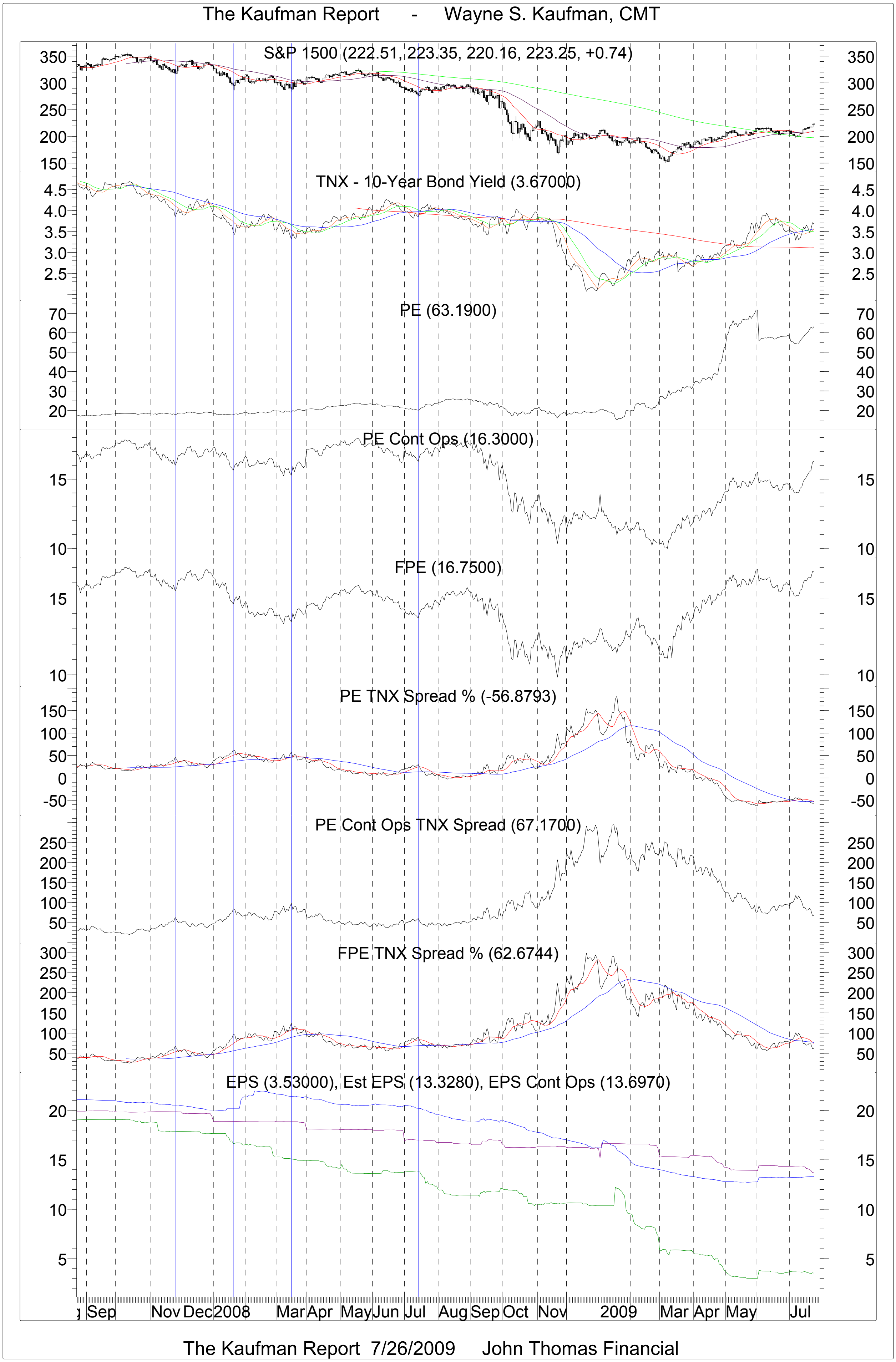


Our statistics of market internals all made new rally highs last week. Average price per share is at its highest level since 10/6/2008.



Our proprietary options indicator has crossed over the neutral line showing options buyers becoming bullish. This is a contrary indicator, which in June told us the pull back would not be too deep due to the pessimism it was showing. It is not yet at levels of optimism we consider dangerous. Still, it merits watching very closely.

Our statistics of supply (red) versus demand (green) show that while buyers have not been that enthusiastic, the statistics of selling are contracting dramatically and in some instances are at the lowest levels seen in years. Unless sellers become motivated, pullbacks will not be deep and the path of least resistance will be up.



P/E ratios continue to move higher. This is starting to concern us.

Spreads between bond and equity yields are moving lower, also a concern.

In spite of 75% of stocks having upside surprises so far in Q2 earnings season, the actual earnings numbers are not moving higher.

The U.S. Dollar Index remains in a down trend just above support.

Crude oil is back above its 50-sma (blue). It is entering a resistance zone.

The commodities index is also back above its 50-sma. We recently said a better index may be the Journal of Commerce Index of Industrial materials (not shown) which is in a beautiful up trend and is at the highest levels since October 2008.

Gold seems poised to move higher, but seems to keep running into resistance in the low 950s. We have said that the near universal bullishness on gold makes us question how high it can rally.